LORD NAPIER AND ETTRICK & ORS.

v.

R.F. KERSHAW LIMITED AND 13 ORS. AND ANOTHER APPEAL

HOUSE OF LORDS
LORD TEMPLEMAN, LORD GOFF OF CHIEVELEY, LORD JAUNCEY OF TULLICHETTLE, LORD BROWNE-WILKINSON, LORD SLYNN OF HADLEY
10 DECEMBER 1992

INSURANCE LAW: Consideration of the principles and the application of the doctrine of subrogation - Whether the insurer has a right to damages received by the assured where the assured has already received insurance monies in respect of the loss.

Two hundred and forty six members of a syndicate, the Outhwaite Syndicate of Lloyd's, (members hereinafter referred to as "the Names") had insured themselves against claims for negligent underwriting of policies. The insurers were Stop-Loss Insurers. There were certain terms in the policy of insurance concerning the limit of the underwriters' liabilities and a clause to indemnify the assured where the nett underwriting loss exceeded the amount stated as "excess" which varied from year to year.

A managing agent of the Syndicate negligently wrote large numbers of policies on behalf of the Names in respect of asbestosis claims without adequate reinsurance cover. The insurers paid to the Name a sum - the fixed amount of the Limit which exceeded the Excess stated in the Schedule. The Names then sued the Syndicate for damages for negligence and breach of duty in respect of the 1982 account wherein they had suffered the underwriting losses. In this suit, the Syndicate paid over £116 million to the solicitors of the plaintiff as a compromise.

Two issues fell for deliberation before the House:

(1) How much was payable to Stop-Loss Insurers by way of subrogation?
(2) Were Stop-Loss entitled to this amount out of the damages recovered and now held by the plaintiffs' solicitors?

(Ed. Note: The figures given are not the actual sums involved but the figures used for purposes of illustration in the judgment**).**

Held:

[1] The Name acts as his own insurer for the first £25,000 and for any loss in excess of £125,000. Out of the loss of £160,000, the Name will have borne the first £25,000 because he agreed with the insurers he will bear that loss. The insurers having paid £100,000 under the policy will receive back £95,000 by way of subrogation.

[2] An insured is not entitled to be indemnified against a loss he has not agreed to bear. The Name must bear the loss to the extent of the excess, being £25,000.

[3]In order to protect the rights of the insurer under the doctrine of subrogation, equity considers that the damages payable by the wrongdoer to the insured are subject to an equitable loan or charge in favour of the insurer. The charge is imposed by equity because the insurer, once he has paid under the policy, has an interest in the right of action against the wrongdoer and an interest in the establishment, quantification, recovery and distribution of the damages awarded against the wrongdoer.

[4] It would therefore be unconscionable for the Names to take their shares of the damages without providing for the sums due to the insurers to be paid out of these damages. The equitable charge still affects the damages and affects the plaintiffs' solicitors who hold the damages with the notice of the charge.

[Stop-Loss Insurers appeal allowed. The Names cross-appeal dismissed].

Cases referred to:

Castellain v. Preston [1883] *11 QBD 380 at 386* ***(refd)***
Randal v. Cockran [1748] 1 Ves. Sen. 99 ***(refd)***
Blaauwpot v. Da Costa [1758] 1 Eden 130 ***(refd)***
Mason v. Sainsbury [1782] 3 Douglas 61 ***(refd)***
Yates v. White [1838] 1 Arnold 85 ***(refd)***
White v. Dobinson [1844] 14 Sim 273 ***(refd)***
Commercial Union Insurance Company v. Lister [1874] 9 Chancery Appeals 483 ***(refd)***
Re Miller, Gibb & Co. Ltd. [1957] 1 WLR 703 ***(refd)***
Yorkshire Insurance Company Ltd. v. Nisbet Shipping Co. Ltd. [1962] 2 QB 330 ***(refd)***
Hobbs v. Marlowe [1978] AC 16 ***(refd)***

London Assurance Co. v. Sainsbury [1783] 3 Dougl. 246 ***(refd)***
Simpson v. Thomson, Burrell [1877] 3 App. Cas. 279 ***(refd)***
King v. Victoria Insurance Co. [1896] AC 250 at pp. 255-6 ***(refd)***
Stearns v. Village Main Reef Gold Mining Co. Ltd. [1905] 10 Com. Cas. 89 ***(refd)***
Burnand v. Rodocancchi, Sons & Co. [1882] 7 App. Cas. 333 at p. 339 ***(refd)***
Morley v. Moore [1936] 2 KB 359 ***(refd)***

Legislation referred to:
Marine Insurance Act 1906, s. 79
Riot Act 1714

Other sources referred to:
Bowstead on Agency, 15th Edn., at pp. 162-163
Bullen & Leake, 3rd Edn., at p. 187
Insurance Law, MacGillivray and Parkington, 8th Edn., paras 1191
Parke on Marine Assurances

JUDGMENT

Lord Templeman

My Lords,

When an insured person suffers a loss he will be entitled to the insurance money and may also be entitled to sue for damages anyone responsible for the loss. For example, if a house is insured for £100,000 against fire and is damaged by fire to an extent exceeding £100,000, the insurance company will pay £100,000. If the fire has been caused by a negligent builder or some other contractual or tortious wrongdoer, the insured person will sue the wrongdoer for damages. If the house has been damaged to the extent of £160,000, the insured person will receive damages from the wrongdoer of £160,000. At that stage the insured person will have made a profit since he will have only suffered a loss of £160,000 but will have collected a total of £260,000 from the insurance company and the wrongdoer. A policy of insurance is however a contract of indemnity and by the doctrine of subrogation the insured person must pay back to the insurer the sum of £100,000. The insured person will then have made neither a loss nor a profit. This appeal requires consideration of the principles and application of the doctrine of subrogation.

The persons insured are 246 members of the Outhwaite Syndicate 317/661 of Lloyd's ("the Names"). The wrongdoer was the managing agent of the syndicate ("Outhwaite") who negligently wrote large numbers of policies on behalf of the Names in respect of asbestosis claims without adequate reinsurance cover. The insurers are the appellants ("the Stop-Loss Insurers").

As members of the Outhwaite Syndicate the Names were entitled to share the nett premiums and personally liable to pay claims received under policies issued by Outhwaite on their behalf in the year of account 1982. The Names were desirous of insuring themselves against part of any loss they might incur as members of the syndicate. Each Name therefore paid a premium to Stop-Loss Insurers for a policy whereby the Stop-Loss Insurers agreed to:

> Indemnify the assured for the amount by which the assured's overall ascertained nett underwriting loss as hereinafter defined for the underwriting year(s) of account shown in the schedule exceeds the amount stated as 'Excess' in the schedule.

The Policy contained a definition of "nett underwriting loss" in the following terms:

> The Underwriters' liability hereunder shall not exceed the amount stated as "Limit" in the Schedule.
>
> The "Limit" and "Excess" shall apply separately to each Underwriting Year of Account covered hereunder.
>
> The term "overall ascertained nett underwriting loss" shall mean:
>
> (a) such sums with which the assured shall be debited by any of his/her Underwriting Agents in respect of his/her underwriting results being the disclosed loss as per the Underwriting Accounts as at the end of the 36th month of each separate Underwriting Year of Account
>
> less
>
> (b) such sums as the assured shall be credited from any of his/her Underwriting results as shown in the account as at the end of the 36th month of each separate Underwriting Year of Account.

One of the underwriting years of account was 1982. The limit and the excess varied from policy to policy.

For purposes of illustration, the arguments in the Courts below and in this House assume

that for the 1982 year of account a particular hypothetical Name suffered a nett underwriting loss of £160,000, that the excess was £25,000, and that the limit was £100,000. On these figures the Stop-Loss Insurers paid to the Name £100,000 being the fixed amount of the limit (£100,000) which exceeded the excess (£25,000). The Names together with other Names sued Outhwaite for damages for negligence and breach of duty in respect of, *inter alia*, the 1982 year of account. Those proceedings were compromised on payment by Outhwaite of £116 million to the respondents Richards Butler as solicitors for the plaintiffs in the action. For the purposes of the illustration it is assumed that included in the sum of £116 million Richards Butler hold £130,000 attributable to the overall ascertained nett loss of £160,000 suffered by the hypothetical Name for the 1982 year of account.

On these assumptions two problems arise, first how much is payable to the Stop-Loss Insurers by way of subrogation? Secondly are the Stop-Loss Insurers entitled to be paid the amounts found due to them by way of subrogation out of the damages now held by Richards Butler?

At first instance Saville J. decided that the hypothetical Name would be entitled to be fully indemnified for his loss of £160,000. He received £100,000 from the Stop-Loss Insurers. He will receive £130,000 from Outhwaite. He will keep £60,000 and pay £70,000 to the Stop-Loss Insurers. In the result the Name will have fully recouped his loss of £160,000. This analysis however ignores the fact that the Name agreed to bear the first £25,000 excess of any loss.

The problem must, in my opinion, be solved by assuming that the Name insured the first £25,000 of any loss and also insured the excess over £125,000 as well as insuring the £100,000 payable under his policy with the Stop-Loss Insurers. There would then be three insurance policies as follows:

(1) A policy for the payment of the first £25,000 of any loss.
(2) A policy for payment of the next £100,000 of any loss.
(3) A policy for payment of any loss in excess of £125,000.

When the Name suffered a loss of £160,000 the Name received £25,000 under the first policy, £100,000 under the second policy and £35,000 under the third policy. The damages payable by Outhwaite were £130,000. The third insurer is entitled to be the first to be subrogated because he only agreed to pay if the first two insurances did not cover the total loss; accordingly the third insurer must be paid £35,000. The second insurer is entitled to be the second to be subrogated because he only agreed to pay if the first insurance cover proved insufficient; accordingly the second insurer must be paid £95,000. The sum of £35,000 payable by way of subrogation to the third insurer and the sum of £95,000 payable by way of subrogation to the second insurer exhausts the damages of £130,000 received by the Name from Outhwaite. There is nothing left to recoup to the second insurer the balance of £5,000 out of the £100,000 he paid under his policy. There is nothing left by way of subrogation for the first insurer in respect of the first £25,000 which he agreed to bear.

Under the Stop-Loss Insurance the Name agreed to bear the first £25,000 loss and any loss in excess of £125,000. In my opinion the name is not entitled to be in a better position than he would have been if he had taken out the three insurances I have mentioned. The Name in fact acts as his own insurer for the first £25,000 loss and acts as his own insurer for any loss in excess of £125,000. So the name must pay £95,000 to the Stop-Loss Insurers just as he would have been liable to pay £95,000 to the second insurer if he had taken out three policies. In the result, out of the loss of £160,000, the Name will have borne the first £25,000 because he agreed with the Stop-Loss Insurers that he would bear that loss. The Stop-Loss Insurers having paid £100,000 under the policy will receive back £95,000 by way of subrogation.

Saville J. reached a different conclusion. He found that the Name was entitled to retain from the damages he received the whole of the loss he had sustained before recouping the Stop-Loss Insurers. Accordingly, the Name who suffered a loss of £160,000 and received £100,000 under the policy with the Stop-Loss Insurers and a further £130,000 from Outhwaite was entitled to retain £60,000 and to recoup to the Stop-Loss Insurers the sum of

£70,000 and no more. Thus the name covered all his loss notwithstanding that he had agreed to bear the first £25,000 of the loss. For his conclusion Saville J. relied on the following passage from the judgment of Brett LJ in *Castellain v. Preston* [1883] 11 QBD 380 at 386:

> The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong.

Saville J. therefore concluded that the Name would be entitled to indemnify himself against the first £25,000 loss even though he had expressly contracted with the Stop-Loss Insurers that he would bear that loss. I do not consider that the case of *Castellain v. Preston* [1883] 11 QBD 380 is helpful in deciding whether a name who promised the Stop-Loss Insurers to bear the first £25,000 loss is entitled to be put in the same position as an insured person who makes no such promise. When Brett LJ delivered his judgment upon which Saville J. relies, he was not concerned with competing claims to subrogation or with any problem arising from underinsurance or partial insurance or layers of insurance. In *Castellain v. Preston* [1883] 11 QBD 380, a vendor after insuring his property against fire contracted to sell the property for £3,100. A fire then occurred and the insurance company paid the vendor £330 in respect of the damage caused by the fire. The purchaser paid the full £3,100 purchase price without deducting anything for the damage caused by the fire. The Court of Appeal held that the insurance company was entitled to be subrogated to the extent of £330 and to receive that sum from the vendor because, as Brett LJ said at p. 390 "the assured have recovered, notwithstanding the loss, from the purchasers the very sum of money which they were to obtain whether this building was burnt or not". In my opinion an insured is not entitled to be indemnified against a loss which he has agreed to bear. I agree therefore with the Court of Appeal that the Name must bear the loss to the extent of the excess, namely £25,000.

The second question is whether the Stop-Loss Insurers have an interest in the moneys held by Richards Butler. For this purpose it may be assumed by way of example that the moneys held by Richards Butler include £130,000 paid by Outhwaite as damages for negligence which inflicted a loss of £160,000 on a name in respect of the 1982 year of account; can the Stop-Loss Insurers assert an interest in that sum of £130,000 to the extent of the £95,000 which, as I have indicated, is due to them by way of subrogation?

When the hypothetical Name suffered a loss of £160,000 as a result of the negligence of Outhwaite, the Stop-Loss Insurers were bound to pay and did pay £100,000 under the policy. The Stop-Loss Insurers immediately became entitled to be subrogated to the right of the Name to sue and recover damages in an action against Outhwaite, albeit that the amount payable to the Stop-Loss Insurers by way of subrogation could not be quantified until the action had been concluded and the damages paid. Nevertheless in my opinion the Stop-Loss Insurers had an interest in the right of action possessed by the Name against Outhwaite. That action, if brought by the Name, would be an action for the benefit of the Name and for the benefit of the Stop-Loss Insurers. Where an insurer has paid on the policy, the Courts have recognised the interests of the insurer in any right of action possessed by the insured person which will enable the insurer to claim back the whole or part of the sum which he has paid under the policy. The Courts recognise the interests of the insurer by allowing him to sue in the name of the insured person against the wrongdoer if the insured person refuses to pursue the action.

In *Randal v. Cockran* [1748] 1 Ves. Sen. 99 a vessel was insured against loss and the insurance company paid the amount of the insurance when the vessel was captured by the Spaniards. The owner of the vessel became entitled to share in the prize money from the sale of captured Spanish vessels in accordance with a Royal Proclamation. The com-

mission for the distribution of the prize money refused to entertain a claim from the insurer. Lord Hardwicke LC:

> ... was of opinion, that the plaintiffs had the plainest equity that could be. The person originally sustaining the loss was the owner; but after satisfaction made to him, the insurer. No doubt, but from that time, as to the goods themselves, if restored in specie, or compensation made for them, the assured stands as a trustee for the insurer, in proportion for what he paid; ...

In *Blaauwpot v. Da Costa* [1758] 1 Eden 130 a ship insured for £1,636 was seized by the Spaniards and the insurance company paid the sum insured. Subsequently prize money amounting to £2,050.18s.6d. was paid to the executors of one of the former owners of the vessel. The executors were ordered to pay the sum £1,636.7s.3d. to the insurers in accordance with the following judgment of the Lord Keeper, Lord Northington:

> I am of opinion that upon the policy, and the peril happening, and the payment of the money by the underwriters, the whole rights of the assured vested in them. The assured had this right of restitution vested in them against the Spanish captors, which was afterwards prosecuted by the Crown by reprisals. Satisfaction having been made in consequence of that capture, I think the plaintiffs are entitled to that benefit; and that it was received by the executors ... in trust for them.

In *Mason v. Sainsbury* [1782] 3 Douglas 61 a house had been insured against damage and the insurance company paid under the policy when damage was caused by the riots of 1780. The insurance company brought an action under the Riot Act 1714 against the local authority. The insurance company sued in the plaintiff's name and with his consent and for the benefit of the insurance company. Lord Mansfield said that the contract of insurance was an indemnity and that "every day the insurer is put in the place of the insured."

In *Yates v. White* [1838] 1 Arnold 85 the owner of a vessel sued the defendant for damaging his ship by collision. The defendant claimed to deduct from the amount of damages the sum which the plaintiff had received from his insurers in respect of such damage. The claim was rejected.

In *White v. Dobinson* [1844] 14 Sim 273 the ship "Diana" was insured against damage. After a collision the insurers paid £205 in respect of the damage. The owner of the vessel, Hicks, was awarded damages of £800 against a defendant who was held liable for the collision. Sir Lancelot Shadwell VC granted an injunction restraining the insured person Hicks from receiving and the wrongdoer Dobbinson from paying the sum of £800 in respect of damages without first paying or providing for the sum £205 in respect of which the insurers were entitled to be subrogated. On appeal Lord Lyndhurst LC at [1844] 116 LTOS 233 said:

> What is an insurance but a contract of indemnity? Then Hicks having received a full satisfaction under the award, what right has he to retain money received from the insurance office as an indemnity for damage? ... If Hicks had received an indemnity before the payment of the money by the company, it would clearly have been contrary to equity that he should retain that money. Parke on Marine Assurances says, that a contract to insure is one of indemnity only, and that the insured shall not receive double compensations for a loss; but in case the loss has been paid, and the insured afterwards recovers the amount of damages from another source, the insurer shall stand in his place to the extent of the sum they have paid.

Hicks then argued that the plaintiff had no remedy in equity and that his only course was an action in a Court of law for money had and received. This argument was rejected and the Lord Chancellor said:

> Here the company have paid for a loss, for which the insured afterwards obtains full satisfaction, and it is contrary to equity that he should retain the money. The underwriters have a claim upon the fund awarded, and they are entitled in some shape or other to recover back the money they have paid.

The injunctions were accordingly upheld.

This is authority for the proposition that if application is made to the Court before the wrongdoer has paid damages in respect of which an insurer is entitled to subrogation, the Court will not allow the damages to be paid over without satisfying the claims of the insurer.

In *Commercial Union Insurance Company v. Lister* [1874] 9 Chancery Appeals 483 the owner of a building insured it for £33,000 against fire but not for the full value. The building was burned by what was said to be the negligence of the servants of a Municipal Corporation and suffered damage estimated at £56,000. The owner brought an action for damages against the corporation. It was held by the Court of Appeal upholding the Master of the Rolls that the owner undertaking to sue for the whole amount of damage would be allowed to conduct the action without interference from the insurers, but would be liable for anything done by him in violation of any equitable duty towards the insurers. In the course of his judgment Sir George Jessel MR had said at p. 484:

> The total amount of the loss is admitted to exceed very largely the total amount of the insurances. It is alleged that the fire was caused ... by the act of the corporation of Halifax ... and that the carelessness was of such a kind as to render the corporation liable for the whole of the loss. In that state of things the insurance company or companies is or are willing to pay the amount of the insurance, and they say that, having paid that amount (they pay of course by way of indemnity), if the assured obtains from the corporation of Halifax a sum larger than the difference between the amount of the insurance and the amount of the loss, he is a trustee for that excess for the insurance company or companies ... - a proposition which I take to be indisputable.

In *Castellain v. Preston* [1883] 11 QBD 380 Brett LJ said at p. 388:

> In order to apply the doctrine of subrogation, it seems to me that the full and absolute meaning of the word must be used, that is to say, the insurer must be placed in the position of the assured. Now it seems to me that in order to carry out the fundamental rule of insurance law, this doctrine of subrogation must be carried to the extent to which I am now about to endeavour to express, namely, as between the underwriter and the assured the underwriter is entitled to the advantage of every right of the assured, whether such right consists in contract, fulfilled or unfulfilled, or in remedy for tort capable of being insisted on or already insisted on, or in any other right, whether by way of condition or otherwise, legal or equitable, which can be, or has been exercised or has accrued, and whether such right could or could not be enforced by the insurer in the name of the assured by the exercise or acquiring of which right or condition the loss against which the assured is insured, can be, or has been diminished.

Clearly Brett LJ considered that an insurer was subrogated to any right of action subsisting when the insurer paid under the policy.

In *Re Miller, Gibb and Co. Ltd.* [1957] 1 WLR 703 the Export Credits Guarantee Department of the Board of Trade issued to a company a policy of insurance for 90 per cent of the amount of any loss sustained in respect of goods sold to Brazil in the event of local regulations preventing payment or a transfer of payment from the buyer to the company. The buyer paid in Brazil into a bank for the account of Martins Bank who were acting for the company. Transfer of this payment was prevented by Brazilian currency exchange regulations and the Department accordingly paid 90 per cent under the terms of the indemnity policy. The company was ordered to be wound up. The Department gave notice to Martins Bank of their claim to be subrogated to the rights of the company with respect to the payment from Brazil when received. In January 1956 the bank received the full purchase price from Brazil and the Board of Trade claimed 90 per cent. Wynn Parry J. ordered the liquidator of the company to execute all such documents and do all such things necessary to enable the Department to obtain from Martins Bank 90 per cent of the sum which had been received by the bank. This case is indistinguishable from the present.

In *Yorkshire Insurance Company Ltd v. Nisbet Shipping Co. Ltd.* [1962] 2 QB 330 a vessel was insured for £72,000 and became an actual total loss. The insurers paid £72,000. The assured brought proceedings in Canada for the loss of the vessel and the defendants paid to the assured in Canada 336,000 odd Canadian dollars then worth £75,000 odd. The pound was devalued and when the damages were transmitted to London they were worth £127,000. Diplock J. held that the doctrine of subrogation only entitled the insurers to recoupment of the £72,000 which they had paid. Diplock J. referred to the doctrine of subrogation in these terms at p. 339:

> The doctrine of subrogation is not restricted to the law of insurance. Although often referred to as an "equity" it is not an exclusively

equitable doctrine. It was applied by the common law courts in insurance cases long before the fusion of law and equity, although the powers of the common law courts might in some cases require to be supplemented by those of the court of equity in order to give full effect to the doctrine; for example, by compelling an assured to allow his name to be used by the insurer for the purpose of forcing the assured's remedies against third parties in respect of the subject matter of the loss ... the expression ''subrogation" in relation to a contract of marine insurance is thus no more than a convenient way of referring to those terms which are to be implied in the contract between the assured and the insurer to give business efficacy to an agreement whereby the assured in the case of a loss against which the policy has been made shall be fully indemnified, and never more than fully indemnified ... In my view the doctrine of subrogation in insurance law requires one to imply in contracts of marine insurance only such terms as are necessary to insure that, notwithstanding that the insurer has made a payment under the policy, the assured shall not be entitled to retain, as against the insurer, a greater sum than what is ultimately shown to be his actual loss. ... Thus, if after payment by the insurer of a loss that loss, as a result of an act of a third party, is reduced, the insurer can recover from the assured the amount of the reduction because that is the amount which he, the insurer, has overpaid under the contract of insurance. This sum he can recover at common law without recourse to equity, as money had and received ... The duty of the assured to take proceedings to reduce his loss and the correlative right of the insurer to require him to do so was a contractual duty. The remedy for its breach, by compelling the assured to allow an action to be brought in his name, was an equitable remedy in aid of rights at common law, and was alternative to the common law remedy of recovering damages for the breach of the duty: ...

In *Hobbs v. Marlowe* [1978] AC 16 Lord Diplock said at p. 39:

> For my own part I prefer to regard the doctrine of subrogation in relation to contracts of insurance as having its origin at common law in the implied terms of the contract and calling for the aid of a court of equity only where its auxiliary jurisdiction was needed to compel the assured to lend his name to his insurer for the enforcement of rights and remedies to which his insurer was subrogated: see *Yorkshire Insurance Co. Ltd v. Nisbet Shipping Co. Ltd.* [1962] 2 QB 330. But the practical effects of the doctrine of subrogation upon the rights and remedies of insurer and assured are similar in many respects to the effect of an equitable assignment of a chose in action.

Thus Lord Diplock, far from deciding that a court of equity could not lend its aid to compel the assured to direct that the insurer be recouped under the doctrine of subrogation out of the damages recovered from the wrongdoer, equated the right of the insurer to that of the assignee of an equitable interest, a right which equity will of course enforce.

It may be that the common law invented and implied in contracts of insurance a promise by the insured person to take proceedings to reduce his loss, a promise by the insured person to account to the insurer for moneys recovered from a third party in respect of the insured loss and a promise by the insured person to allow the insurer to exercise in the name of the insured person rights of action vested in the insured person against third parties for the recovery of the insured loss if the insured person refuses or neglects to enforce those rights of action. There must also be implied a promise by the insured person that in exercising his rights of action against third parties he will act in good faith for the benefit of the insured person so far as he has borne the loss and for the benefit of the insurer so far as he has indemnified the insured person against the insured loss. My Lords, contractual promises may create equitable interests. An express promise by a vendor to convey land on payment of the purchase price confers on the purchaser an equitable interest in the land. In my opinion promises implied in a contract of insurance with regard to rights of action vested in the insured person for the recovery of an insured loss from a third party responsible for the loss confer on the insurer an equitable interest in those rights of action to the extent necessary to recoup the insurer who has indemnified the insured person against the insured loss.

In the hypothetical case under consideration, the intervention of equity is required to ensure that the insured person exercises his right of action against the wrongdoer in good faith and that the insurer is recouped out of the damages recovered from the wrongdoer. The Stop-Loss Insurer is out of pocket to the amount of £100,000 from the time that he pays, as he must pay, £100,000 to the Name immediately the loss has been suffered. The

Stop-Loss Insurer is entitled to be recouped £95,000 as soon as the damages of £130,000 are available from the wrongdoer. The Name cannot delay or frustrate recoupment without inflicting harm on the insurer who remains out of pocket to the extent of £100,000 until he is recouped. The Name cannot make use of the damages payable by the wrongdoer and available for recoupment of the Stop-Loss Insurers without the Name receiving a benefit or advantage to which he is not entitled. When I asked why the Names were defending these present proceedings, your Lordships were blandly informed that the Names wished to benefit their "cash flow" by making use of all the damages payable by Outhwaite and deferring recoupment until each Stop-Loss Insurer was able to obtain a judgment against each name for money had and received. The Stop-Loss Insurers were not in a position to sue the Name to whom they had paid £100,000 until the action against Outhwaite resulted in judgment or compromise which included £130,000 for the insured loss and the damages of £130,000 had been paid to the Name; they were even then not in a position to sue the Name until the amount which the Stop-Loss Insurers were entitled to recoup under the doctrine of subrogation had been ascertained and calculated. There are 246 names, some of whom are resident in the United States of America and elsewhere abroad. In order to succeed in an action for money had and received Stop-Loss Insurers might be obliged to pursue litigation at considerable expense and subject to considerable delay in a country which knows nothing of an action for money had and received or does not recognise the doctrine of subrogation or confines its civil litigation to the tender mercies of juries who are unsympathetic towards insurers. By the time that the Stop-Loss Insurers ascertain that they are entitled to be repaid the sum of £95,000 and no more and no less under the doctrine of subrogation and bring and succeed in a claim against the hypothetical Name to be paid £95,000, whether judgment for that sum be obtained at home or abroad, the Name, having had and received £100,000 from the Stop-Loss Insurers, may not be in a position to pay back £95,000. We were informed and accept that the respondent and representative Name Lord Napier and Ettrick is a man of honour and substance and will fulfil his obligations although he is not apparently willing to fulfil them until a writ is issued and judgment is obtained against him for money had and received. But no one can answer for the other 245 Names.

If the Stop-Loss Insurers have no equitable remedy in connection with their rights and if a name becomes bankrupt then subrogation is a mockery. Suppose, for example, that a name receives £100,000 from an insurer under a policy, recovers judgment for £130,000 damages from the wrongdoer and the name goes bankrupt before he receives the damages owing £1 million and possessing no assets other than assets representing the £100,000 he has received from the insurer and the asset of £130,000 payable by the wrongdoer. In that case, if the argument on behalf of the Names is correct, the unsecured creditors of the insured Name will benefit by double payment. The Stop-Loss Insurers will be in a worse position than an unsecured creditor because the insurers could resist payment under the policy whereas an unsecured creditor may choose whether to advance moneys or not. In the case of the bankruptcy of the Name, the right of the insurer to subrogation will be useless unless equity protects that right.

Saville J. and the Court of Appeal held that the Stop-Loss Insurers were confined to their remedy for money had and received. The damages must first be distributed to the Names. The Stop-Loss Insurers must then agree or determine by application to the Court the amount due to them respectively and must then bring proceedings for money had and received against each of the Names. All the authorities which indicated that an insurer who pays on the policy and is entitled to recoupment by way of subrogation has an equitable interest in the right of action of the insured person against a wrongdoer and an equitable interest in the damages payable by the wrongdoer were said not to be binding on the Courts. Those authorities which I have cited, and there are others, included *Randal v. Cockran* decided in 1748, *White v. Dobinson* decided in 1844, *Commercial Union v. Lister* decided in 1874 and *Re Miller, Gibb and Co. Ltd.* decided in 1957. I am not prepared to treat authorities which span over two centuries in a cavalier fashion. The principles which dictated the decisions of our ancestors and inspired their references to the equitable obligations of an insured person towards

an insurer entitled to subrogation are discernible and immutable. They establish that such an insurer has an enforceable equitable interest in the damages payable by the wrongdoer. The insured person is guilty of unconscionable conduct if he does not provide for the insurer to be recouped out of the damages awarded against the wrongdoer. Equity will not allow the insured person to insist on his legal rights to all the damages awarded against the wrongdoer and will restrain the insured person from receiving or dealing with those damages so far as they are required to recoup the insurer under the doctrine of subrogation.

Where the insured person has been paid policy moneys by the insurer for a loss in respect of which the insured person recovers damages from a wrongdoer the insured person is guilty of unconscionable conduct if he does not procure and direct that the sum due to the insurer shall by way of subrogation be paid out of the damages.

It is next necessary to consider how equity copes with such unconscionable conduct. Saville J. and the Court of Appeal appear to have thought that equity can only interfere by creating a trust fund held in trust by trustees for different beneficiaries in different shares, the trustees being burdened with administrative and investment duties, the trustees being liable for all the duties imposed on trustees but being free from liability if the trust fund is lost without negligence. I agree that if this were the only method of protecting the rights of an insurer the practical disadvantages would be fearsome. Fortunately, equity is not so inflexible or powerless. In order to protect the rights of the insurer under the doctrine of subrogation equity considers that the damages payable by the wrongdoer to the insured person are subject to an equitable lien or charge in favour of the insurer. The charge is imposed by equity because the insurer, once he has paid under the policy, has an interest in the right of action against the wrongdoer and an interest in the establishment, quantification, recovery and distribution of the damages awarded against the wrongdoer. It would be unconscionable for the insured person, who has received £100,000 from the insurer, to put damages of £130,000 into his own pocket without providing for the recoupment of the insurer who only contracted to indemnify the insured person.

The insurer can give notice to the wrongdoer of his equitable charge. When the wrongdoer is ordered or agrees to pay £130,000 and has notice of the rights of the insurer to subrogation, the wrongdoer can either pay the damages into Court or decline to pay without the consent of both the insured person and the insurer. It would be the duty of the insured person to direct the wrongdoer to pay £95,000 of the damages to the insurer in recoupment and to pay the balance of £35,000 to himself. The equitable charge in favour of the insurer is enforceable against the damages ordered to be paid; that charge can be enforced so long as the damages form an identifiable separate fund. If, in the present case, Richards Butler had distributed the damages to the Names before the Stop-Loss Insurers issued proceedings or notified Richards Butler of their equitable charge, the Stop-Loss Insurers would have been reduced to exercising their rights to sue the Names for money had and received.

In the present case damages of £116 million are in a separate fund held by Richards Butler on behalf of the Names *albeit* that the damages in the fund also include moneys held on behalf of other Names and other insurers. For the reasons I have indicated it would be unconscionable for the Names to take their shares of the damages without providing for the sums due to the Stop-Loss Insurers to be paid out of those damages. The equitable charge still affects the damages and affects Richards Butler who hold the damages with notice of the charge.

It is true that it may not be possible to distribute the damages between the Stop-Loss Insurers and the Names at once because the amounts due to the Names as opposed to other Names may still be uncertain and because the amounts due to the Stop-Loss Insurers in any particular case by way of subrogation may still be uncertain. These uncertainties are due to the fact that losses of Lloyd's Underwriters surface and are quantified in some cases many years after the relevant year of account. The calculations are also complicated by the fact that the damages of £116 million are in compensation of claims extending over different years of account with different Names and insurers and with insurance policies containing different provisions. Delay in distributing the damages cannot be blamed on the Stop-Loss Insurers. Delay is as much a

disadvantage to the Stop-Loss lnsurers as it is to the Names. It is in the interests of everybody that the damages shall be distributed as soon as possible. Interim distributions can be made in favour of those Names and Stop-Loss Insurers whose rights and liabilities have been or are now capable of being calculated with certainty. If necessary the Court will decide how much can now be distributed. Any reserves for uncertain events can be invested in joint names for the benefit of the Name and the Stop-Loss Insurers concerned.

In the result I would allow the appeal by the Stop-Loss Insurers against the refusal of Saville J. and the Court of Appeal to grant any relief in equity against the Names and Richards Butler. In my opinion the Stop-Loss Insurers are entitled to injunctions restraining Richards Butler from paying and each Name from receiving any part of the damages of £116 million now held by Richards Butler without first providing or paying out of the damages payable to the Name the amounts which have been or shall be found to be due from that Name to the Stop-Loss Insurers by way of subrogation.

I would dismiss the cross-appeal by the Names against the declaration made by the Court of Appeal in these terms:

> That, when determining the amount which Stop-Loss Insurers are entitled to claim in respect of the Settlement moneys, the Stop-Loss Insurers are entitled to be reimbursed any indemnity paid by them to an assured before that assured is fully indemnified by applying his share of the settlement moneys to a loss occurring below the excess in that assured's policy.

Since drafting this speech I have read in draft the speech to be delivered by my noble and learned friend Lord Goff of Chieveley. He agrees that the doctrine of subrogation confers on the insurer an equitable proprietary lien or charge on the moneys recovered by the insured person from a third party in respect of the insured loss. I agree that in the circumstances it is not now necessary to decide whether the equitable lien or charge attaches also to the rights of action vested in the insured person to recover from a third party. I have expressed the view that the doctrine of subrogation does apply in those circumstances but in any future case, if the point becomes material, that view may require reconsideration in the light of further research. Subject to this observation I agree with the views expressed by Lord Goff and I also agree with the speeches to be delivered by my noble and learned friends Lord Jauncey of Tullichettle and Lord Browne-Wilkinson.

The Names must pay the costs of the Stop-Loss Insurers before this House and in the Courts below.

Lord Goff of Chieveley

My Lords,

I, too, have reached the conclusion that the appeal should be allowed. I start with the common law. In *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.* [1962] 2 QB 330, a case concerned with marine insurance, Lord Diplock (then Diplock J.) analysed the principle of subrogation in purely contractual terms. He said (at pp. 339-340):

> The expression 'subrogation' in relation to a contract of marine insurance is thus no more than a convenient way of referring to those terms which are to be implied in the contract between the assured and the insurer to give business efficacy to an agreement whereby the assured in the case of a loss against which the policy has been made shall be fully indemnified, and never more than fully indemnified.

He went on to say (at p. 340) that subrogation is concerned solely with the mutual rights and liabilities of the parties to the contract of insurance. The remedies of the insurer were, he said, essentially common law remedies; in particular, if the assured has, after payment of the loss by the insurer, received a sum from a third party in reduction of the loss, the insurer can recover the amount of the reduction as money had and received (for which Lord Diplock referred to Bullen & Leake, 3rd Edn., at p. 187). The only role which Lord Diplock assigned to equity was to come to the aid of the common law by compelling the assured to allow his name to be used in proceedings against the third party: see also his judgment in *Hobbs v. Marlowe* [1978] AC 16 at p. 39.

Now there is no reason why, subject to the one matter to which Lord Diplock refers, the principle of subrogation in the field of insurance should not have developed as a purely common law principle. But as a matter of history it did not do so. It is true that our law

of marine insurance was very largely established by Lord Mansfield, in a remarkable series of decisions during his tenure of office as Chief Justice at the Court of King's Bench, so much so that Park J. dedicated the first edition of his treatise on the law of marine insurance to Lord Mansfield, describing the subject in the dedication as one which "must be admitted to be the exclusive property of your Lordship". But in the early editions of the book there is little trace of the principle of subrogation, though there is much learning on the subject of abandonment. Lord Mansfield's decision in the leading case of *Mason v. Sainsbury* [1782] 3 Dougl. 61 established that payment of a claim by an insurer did not preclude him from thereafter proceeding in the name of the assured against the wrongdoer who had caused the relevant damage, and recovering damages in full from him. The payment of the loss by the insurer to the assured did not affect the liability of the wrongdoer; the action against him was to be considered "as if the insurer had not paid a farthing" (see p. 64). However the insured could not proceed against the third party in his own name; he had to proceed in the name of the assured (see *London Assurance Co. v. Sainsbury* [1783] 3 Dougl. 246).

It is of some interest that, in *Mason v. Sainsbury*, the action against the wrongdoer was brought in the name of the assured with his consent, for the benefit of the insurer. Here we can see an early example of the fact that the insurer, upon payment to the assured of his loss, receives from him as a matter of course not merely a receipt for the money, but also what has for many years been called a letter of subrogation signed by the assured which authorises the insurer to proceed in this way, and indeed nowadays may assign the relevant rights of action to the insurer. It is very difficult to imagine an insurer paying a claim without taking this elementary precaution, especially as the assured can have little or no incentive to refuse to sign such a document. I strongly suspect that letters of subrogation have been a commonplace of insurance claims for a very long time; and that it is their regular use which explains what appears to be a dearth of authority on such matters as proceedings to compel the assured to allow the insurer to commence proceedings in his name, and actions for money had and received by insurers against assured, because third parties would have settled direct with the insurer as expressly authorised by the assured (hence, **pace** Lord Diplock, the absence of any reference to such an action in *Bullen & Leake* 3rd Edn). On the other hand, there is a substantial body of case law on the subject of the respective rights of insurer and assured in the institution, control and settlement of proceedings against wrongdoers who have caused the relevant loss (as to which see MacGillivray and Parkington on Insurance Law, 8th Edn., paras. 1191 *et seq.*).

At all events, what appears to have happened is not simply that equity came to the aid of the common law by compelling an assured whose loss has been paid to allow the insurer to proceed in his name against a third party wrongdoer responsible for the loss, but that a principle of subrogation was the subject of separate development by Courts of equity in a line of authority dating from *Randal v. Cockran* [1748] 1 Ves. Sen. 99, which was decided before Lord Mansfield was appointed Chief Justice of the Court of King's Bench. This line of authority is traced in the speech of my noble and learned friend Lord Templeman, and I am therefore spared the burden of setting it out in this opinion. Spasmodic but consistent, the cases assert that recoveries by the assured which reduce the loss paid by the insurer are held in trust for the insurer, so much so that by 1881 Sir George Jessel MR regarded this proposition as indisputable (see *Commercial Union Insurance Co. v. Lister* [1874] reported in 9 Ch. App. 483 at p. 484n.) This principle was moreover recognised not only in Courts of equity, but also in Courts of common law (see the decision of the Court of Common Pleas in *Yates v. White* [1838] 1 Arnold 85, 4 Bing. (NC) 272, subsequently approved by this House in *Simpson v. Thomson, Burrell* [1877] 3 App. Cas. 279, in which Lord Cairns LC (at pp. 285-6) cited ***in extenso*** passages from the judgment in *Yates v. White* in which reliance was placed on *Randal v. Cockran*, and Lord Blackburn (at p. 293) relied on *Randal v. Cockran* itself in a passage to which I shall refer later in this opinion. It is perhaps also relevant that in 1783 Lord Mansfield had justified his conclusion that the insurer could not proceed in his own name but must proceed in the name of the assured on the ground that "Trustee and *cestui que trust* cannot both have a right of action": see *London Assurance Co. v. Sainsbury* [1783] 3 Dougl. 249, 253.

I agree with my noble and learned friend Lord Browne-Wilkinson that the decisive case in the line of equity cases is *White v. Dobinson* [1844] 14 Sim. 273, 116 LTOS 233. The case was concerned with a collision at sea. The owner of one of the ships, after payment by his underwriter of £205, was awarded £600 damages in arbitration proceedings against the other shipowner. Sir Launcelot Shadwell VC, relying upon *Randal v. Cockran* [1748] 1 Ves. Sen. 99 and *Blaawpot v. da Costa* [1758] 1 Eden 130, granted an interlocutory injunction which had the effect of retaining the fund, and not letting it pass into the hands of the assured. The injunction appears to have restrained both the assured from receiving, and the other shipowner from paying, the money without first paying or providing for the sum of £205 paid by the insurer (see the report in 116 LTOS 233). Lord Lyndhurst LC discharged the injunction as against the other shipowner, but otherwise maintained it in force. The case is important for a number of reasons. First, the insurer's case was advanced on the basis that he had a lien on the sum awarded, and was resisted on the ground that the insurer's right, if it existed at all, was a right to proceed at law in an action for money had and received, and was not an equitable right. That argument was rejected. Second, the Lord Chancellor also rejected a claim by a bank as assignee from the assured, on the ground that the bank's security was taken subject to all the equities which would have affected the money received in the hands of the assured himself. Third, the Lord Chancellor held that the insurers had a claim upon the fund awarded, and were "entitled in some shape or other to recover back the money they have paid".

Now it is true that the case was concerned with an interlocutory injunction, a point which evidently concerned the Lord Chancellor himself. But he nevertheless upheld the injunction on the basis of the authority cited to him, in which, as he said, "We have the clearly expressed opinions of Lord Hardwicke and Lord Northington, recognised by Mr. Baron Parke, and more recently by Lord Abinger, who at that time possessed considerable experience of the practice in equity, from having presided for several years on the equity side of the Court of Exchequer" (see 116 LTOS 233). Subsequent authorities to the same effect are *King v. Victoria Insurance Co.* [1896] AC 250 at pp. 255-6 per Lord Hobhouse who (in a passage in which he appears to have placed no reliance upon the existence of an assignment by the assured of its rights and causes of action against the third party) expressed the opinion that the assured would have held any damages recovered from the third party as trustee for the insurer; and *In re Miller, Gibb & Co.* [1957] 1 WLR 703. The only case in equity which appears at first sight to be inconsistent with this line of authority is *Stearns v. Village Main Reef Gold Mining Co. Ltd.* [1905] 10 Com. Cas. 89. However, as my noble and learned friend Lord Browne-Wilkinson has pointed out, that case was concerned with the recovery of an overpayment; indeed, it was upon that basis that it was distinguished by Wynn-Parry J. in *In re Miller Gibb & Co.* at pp. 710-711.

Despite Saville J.'s reservations on this point, I can discern no inconsistency between the equitable proprietary right recognised by courts of equity in these cases and the personal rights and obligations embodied in the contract of insurance itself. No doubt our task nowadays is to see the two strands of authority, at law and in equity, moulded into a coherent whole; but for my part I cannot see why this amalgamation should lead to the rejection of the equitable proprietary right recognised in the line of cases to which I have referred. Of course, it is proper to start with the contract of insurance, and to see how the common law Courts have worked out the mutual rights and obligations of the parties in contractual terms with recourse to implied terms where appropriate. But, with all respect, I am unable to agree with Lord Diplock that subrogation is in this context concerned **solely** with the mutual rights and obligations of the parties under the contract. In this connection, I observe from the report of *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.* [1962] 2 QB 330, that the important case of *White v. Dobinson* [1844] 14 Sim. 273, 116 LTOS 233, was not cited in argument, and indeed the existence of an equitable proprietary right was not in issue in that case. In these circumstances I cannot derive from Lord Diplock's judgment any justification for sweeping the line of equity cases

under the carpet as though it did not exist. In my opinion, this line of authority must be recognised, and appropriate weight should be given to the views expressed in the cases by the distinguished Judges who decided them. I wish to add that I do not read s. 79 of the Marine Insurance Act 1906 (concerned with the right of subrogation) as in any way detracting from this conclusion.

Even so, an important feature of these cases is that the principle of subrogation in the law of insurance arises in a contractual context. It is true that in some cases at common law it has been described as arising as a matter of equity. Thus in *Burnand v. Rodocanachi, Sons & Co.* [1882] 7 App. Cas. 333 at p. 339, Lord Blackburn described it simply as "an equity". Furthermore, it has not been usual to express the principle of subrogation as arising from an implied term in the contract. Even so it has been regarded, both at law and in equity, as giving effect to the underlying nature of a contract of insurance, which is that it is intended to provide an indemnity but no more than an indemnity. Not only does this principle inform the judgments of the Court of Appeal in the leading case of *Castellain v. Preston* [1883] 11 QBD 380, but it underlies Lord Lyndhurst's judgment in *White v. Dobinson* [1844] 116 LTOS 233. In so far as the principle requires the payment of money, it could no doubt be formulated as an implied term, to which effect could have been given by the old action for money had and received. But I do not see why the mere fact that the purpose of subrogation in this context is to give effect to the principle of indemnity embodied in the contract should preclude recognition of the equitable proprietary right, if justice so requires. If I search for a parallel, the closest analogy is perhaps to be found in the law of agency in which, although the relationship between principal and agent is governed by a contract, nevertheless the agent may be held in certain circumstances to hold money, which he has received from a third party in his capacity as agent, as trustee for his principal. It is by no means easy to ascertain the circumstances in which a trusteeship exists; but, in a valuable discussion in Bowstead on Agency 15th Edn., at pp. 162-163, Professor Francis Reynolds suggests that it is right to inquire "whether the trust relationship is appropriate to the commercial relationship in which the parties find themselves; whether it was appropriate that money and property should be, and whether it was, held separately, or whether it was contemplated that the agent should use the money property or proceeds as part of his normal cash flow in such way that the relationship of debtor and creditor is more appropriate". He also suggests that "a central question, perhaps too often overlooked (because not directly an issue), is whether the rights of the principal are sufficiently strong, and differentiable from other claims, for him to be entitled to a prior position in respect of them on the agent's bankruptcy". I have little doubt that the distinguished Judges who decided the cases in the line of equity authority to which I have referred, must have considered that money received by an assured by a third party in reduction of a loss paid by an insurer should not be treated as available for the assured's normal cash flow, and further that the rights of the insurer to such money were sufficiently strong to entitle the insurer to priority in the event of the assured's bankruptcy, as was indeed held by Wynn-Parry J. in *In re Miller, Gibb & Co.* [1957] WLR 703. I for my part can see no good reason to depart from this line of authority. However, since the constitution of the assured as trustee of such money may impose upon him obligations of too onerous a character (a point which troubled Saville J. in the present case), I am very content that the equitable proprietary right of the insurer should be classified as a lien, as proposed by my noble and learned friend Lord Templeman, and indeed as claimed by the insurer in *White v. Dobinson* [1844] 14 Sim. 237 itself. Indeed a lien is the more appropriate form of proprietary right in circumstances where, as here, its function is to protect the interest of the insurer in an asset only to the extent that its retention by the assured will have the effect that he is more than indemnified under the policy of insurance.

There is one particular problem to which I wish to refer, although, as I understand it, it does not fall to be decided in the present case. Does the equitable proprietary interest of the insurer attach only to a fund consisting of sums which come into the hands of the assured in reduction of the loss paid by the insurer? Or does it attach also to a right of action vested in the assured which, if enforced, would yield such a fund? The point is

not altogether easy. I can see no reason in principle why such an interest should not be capable of attaching to property in the nature of a chose in action. Moreover that it should do so in the present context appears to have been the opinion of Lord Blackburn in *Simpson v. Thomson, Burrell* [1877] 3 App. Cas. 279 at pp. 292-3. On the other hand, cases such as *Morley v. Moore* [1936] 2 KB 359 appear to point in the opposite direction, as perhaps does the decision of Lord Lyndhurst in *White v. Dobinson* [1844] 116 LTOS 256 to discharge the injunction as against the owner of the ship at fault in that case. However, since the point was not directly addressed in the argument before your Lordships, I am reluctant to reach any conclusion upon it without a full examination of the authorities relating to the respective rights and obligations of insurer and assured, especially with regard to the conduct and disposal of litigation relating to causes of action of the relevant kind. I therefore wish to reserve my opinion upon this question, the answer to which I do not regard as necessary for the resolution of the issue which has arisen in the present case.

For these reasons, I would allow the appeal. For the reasons given by my noble and learned friends, Lord Templeman and Lord Jauncey of Tullichettle, I would dismiss the cross-appeal.

Lord Jauncey of Tullichettle

My Lords,

I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Templeman, Lord Goff of Chieveley and Lord Browne-Wilkinson. I agree that for the reasons which they have given the appeal of the Stop-Loss Insurers should be allowed and I cannot usefully add anything to what they have said. I also agree that the cross-appeal by the Names should be refused and wish only to add a few words of my own thereanent.

The cross-appeal raises the question of how moneys recovered ("the recoveries") by the Names in the Outhwaite actions are to be applied as between the Names and the Stop-Loss Insurers. A typical policy granted by the Stop-Loss Insurers undertook to "indemnify the assured for the amount by which the assured's overall ascertained nett underwriting loss as hereinafter defined for the Underwriting Year(s) of Account shown in the Schedule exceeds the amount stated as 'Excess' in the schedule." The policy further provided that the insurers liability should not exceed a specified limit. The Names contended that the recoveries should be applied first towards their losses above the specified limit, second towards their losses up to the excess and thereafter to the Stop-Loss Insurers. The latter accepted that the recoveries should be applied in the first instance towards the 'Names' losses above the specified limit but contended that they should then be applied for their benefit. The competing arguments may perhaps be best illustrated by a hypothetical example which was relied upon in the Court of Appeal and before this House. A Name having a policy with an excess of £25,000 and insurers' liability limited to £100,000 suffers a total loss of £160,000, but receives £100,000 under his policy and later recovers £130,000 in the action. The Names argued that the £130,000 fell to be applied as to £35,000 to meet the uninsured top slice of the loss, as to £25,000 to meet the initial excess and as to the remaining £70,000 for the benefit of the Stop-Loss Insurers. There was no dispute as to the application of £35,000 but the Stop-Loss Insurers maintained that the remaining £95,000 should be applied for their benefit leaving them with a liability to the insured of only £5,000. In short the question was whether the Names were entitled to recoup themselves out of the recoveries for their initial uninsured £25,000 loss in priority to the Stop-Loss Insurers. Saville J. held that the Names were so entitled but the Court of Appeal held that they were not. Your Lordships were informed that a sum of about £6 million was affected by this issue.

The basis of the Stop-Loss Insurers' right to receive any part of the recoveries is the doctrine of subrogation. In *Castellain v. Preston* [1883] 11 QBD 380, Brett LJ at p. 386 said:

> The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified.

He later went on to give an enlarged definition of subrogation pointing out at p. 388 that "the insurer must be placed in the position of the assured." He pointed out that although an insurer who had not yet fully indemnified an insured could not, in relation to prior recoveries, be subrogated to any right of action nevertheless it would be contrary to the doctrine of subrogation if the insured's loss were not diminished *vis-a-vis* the insurer. Brett LJ was thus equiparating the effect of recoveries made before indemnification by the insurer with those made afterwards. In the case of recoveries made towards a loss which was indemnifiable but had not yet been indemnified the matter could equally well be approached by saying that the loss which the insurer had undertaken to meet was the initial loss diminished by all relevant recoveries prior to payment by the insurer. This appears to have been the approach of Cotton LJ in *Castellain v. Preston* where after referring to the loss insured against he said at p. 393:

> In order to ascertain what that loss is, everything must be taken into account which is received by and comes to the hand of the assured, and which diminishes that loss. It is only the amount of the loss, when it is considered as a contract of indemnity, which is to be paid after taking into account and estimating those benefits or sums of money which the assured may have received in diminution of the loss.

At p. 395 he said:

> The principle which I have enunciated goes further, and if there is a money or any other benefit received which ought to be taken into account in diminishing the loss or in ascertaining what the real loss is against which the contract of indemnity is given, the indemnifier ought to be allowed to take advantage of it in order to calculate what the real loss is, ...

A similar approach was adopted by Lord Blackburn in *Burnand v. Rodocanachi* 7 App. Cas. 333 p. 339 in these words:

> The general rule of law (and it is obvious justice) is that where there is a contract of indemnity (it matters not whether it is a marine policy, or a policy against fire on land, or any other contract of indemnity) and a loss happens, anything which reduces or diminishes that loss reduces or diminishes the amount which the indemnifier is bound to pay; and if the indemnifier has already paid it, then, if anything which diminishes the loss comes into the hands of the person to whom he has paid it, it becomes an equity that the person who has already paid the full indemnity is entitled to be recouped by having that amount back.

What is, in my view, particularly significant about the foregoing *dicta* is the emphasis which they place upon the fact that in the context of recoveries subrogation is concerned only with the loss against which the assured is insured rather than any general loss. If an assured has suffered an insured loss and an uninsured loss full indemnification of the former subrogates the insurers irrespective of the fact that the assured has not yet recovered the uninsured loss.

Saville J. in rejecting the argument of the Stop-Loss Insurers said that it "involves the proposition that they can take account of the recovery before the assured has been reimbursed for his loss". He concluded his judgment by saying:

> The question to be asked ... is whether the recovery together with the indemnity will more than compensate the assured for the loss. If it will, then if this arises before payment, the amount of the indemnity will be reduced so as to avoid over-compensation, while if it occurs after payment, the assured will have to repay the amount of over-compensation to his indemnifiers. I can only repeat that any approach which does not achieve this result but instead leaves the assured over or under-compensated must be wrong, since it offends the very reason why subrogation exists in our law.

With respect to the learned Judge it seems to me that he was there confusing the whole loss suffered by the assured with the loss against which the insurer had agreed to indemnify him. When the indemnity extends to the total loss sustained the two will be coincident but in the present case they were not. In my view Staughton LJ was correct in stating that "it is [the loss against which the policy has been made (sic)] which the insurer must have been reimbursed for, if the insurer is to claim any benefit by way of subrogation".

In this case the Stop-Loss Insurers undertook to indemnify the assured for the amount by which their overall ascertained underwriting loss exceeded a specified excess but did not exceed a stated limit. In the given example they undertook to meet losses neither below £25,000 nor above £125,000. When they paid over the £100,000 to the Names the latter

were fully indemnified against the insured loss although they themselves had further uninsured losses of £60,000 and the Stop-Loss Insurers were subrogated to any recoveries which reduced the insured loss. If in the given example recovery of £130,000 had been achieved before the Stop-Loss Insurers were called upon to pay what would have been the loss which the Names had at that stage sustained? The insurers would answer "£30,000" upon the view that a recovery of £130,000 had reduced an initial loss of £160,000 to that figure. The Names however would answer,

> We have sustained a loss £30,000 lying within a band between £25,000 and £55,000 which loss we are entitled to indemnity from the insurers.

My Lords, not only does the 'Names' answer defy common sense but it also involves their accepting that they have sustained no loss in respect of the initial excess, a loss whose existence is a prerequisite to any liability on the part of the Stop-Loss Insurers. To put the matter another way the 'Names' answer involves treating the "loss against which the policy has been made" not as provided for in that policy but as the first £100,000 without excess, an exercise for which there is, in my view, no warrant whatsoever. Suppose that instead of carrying the first £25,000 themselves the Names had insured that sum with another insurer. Could they on receipt of the £130,000 of recoveries have paid £25,000 to that insurer at the expense of the Stop-Loss Insurers? The answer can only be "no." The fact that they have chosen to carry their own insurance for that sum cannot in my view place them in a better position *vis-a-vis* the other insurers than would have been an insurer of that sum. When an insured loss is diminished by a recovery from a third party, whether before or after any indemnification has been made, the ultimate loss is simply the initial loss minus the recovery and it is that sum to which the provisions of the policy of assurance apply including any provision as to an excess.

My Lords for the foregoing reasons and for those given by my noble and learned friend Lord Templeman I consider that the Court of Appeal reached a correct conclusion on this matter and that the cross appeal should be dismissed.

Lord Browne-Wilkinson

My Lords,

I agree with the speeches of my noble and learned friends Lord Templeman and Lord Jauncey of Tullichettle. I add some words of my own on the question whether the Stop-Loss Insurers have a proprietary interest in the damages recovered by the Names from Outhwaite because we are differing from the Court of Appeal on that point.

Dillon LJ (with whom Staughton and Nolan L.JJ. agreed on this point) based his conclusion that the doctrine of subrogation does not give rise to any proprietary interest primarily on the statement of the law by Lord Diplock in *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.* [1962] 2 QB 330 at p. 339 and *Hobbs v. Marlowe* [1978] AC 16 at p. 39. Lord Diplock said, in effect, that in relation to insurance the right of subrogation was a common law doctrine based on the implied terms of the contract of insurance, the role of equity being limited to aiding the common law right of recovery by forcing the assured to permit the insurers to sue third parties in the name of the assured. It was the view of the Court of Appeal that, as a common law doctrine, the right of subrogation enjoyed by insurers was unlikely to give rise to a trust or other equitable or proprietary right.

However, the researches of Counsel in the present case have failed to disclose any reported decision before the fusion of law and equity in which an insurer successfully sued the assured at law for money had and received, being moneys recovered by the assured from a third party wrongdoer in reduction of the insured loss. Nor has any case been found in which a Court of equity was asked to make an order directing the assured to permit the insurers to sue in the name of the assured. Nor can I find in Bullen and Leake, 3rd Edn., p. 187 (on which Lord Diplock relied in the *Yorkshire Insurance* case at p. 341) any precedent for a common law action for money had and received brought by the insurer against the insured.

On the other side, the authorities cited by Lord Templeman show a series of decisions from 1748 onwards in which Courts of equity were themselves enforcing rights of

subrogation against the assured and in which both equity and common law Courts referred to the assured as holding benefits received from a third party as "trustee" for the insurers or subject to a lien in favour of the insurers.

In my judgment therefore Lord Diplock's *dicta* are not well founded if they suggest that subrogation in insurance cases was purely a common law doctrine and that equity only intervened for the purpose of enabling the insurer to sue in the name of the assured. Equity itself enforced rights of subrogation against the assured. Despite the lack of reported cases, it may well be that before 1875 the common law also recognised the right of insurers to sue the assured for money had and received. The probability is that in the majority of cases there was a letter of subrogation obtained from the assured when the insurance moneys were paid. Such a letter would regulate the rights of the insurers to sue and the destination of the moneys recovered.

What, then, was the basis on which equity enforced rights of subrogation? Was it merely a personal obligation of the assured to account to the insurers for benefits received from third party wrongdoers in diminution of the insured loss, or was it a proprietary right of the insurers in the damages recovered from third parties? In my judgment, the authorities show that it was a proprietary right in the damages recovered.

First, the question arose whether in an action at law by the assured against the third party wrongdoer, the damages recoverable had to be reduced by the amount of the insurance moneys received by the assured. It was argued that unless such reduction were made, the assured would be obtaining double compensation. In *Yates v. White* [1838] 1 Arnold 85 such an argument was rejected by the Court of common pleas on the ground that the assured was not making a double recovery since he would be a trustee for the insurers of the moneys recovered from the third party wrongdoer. Tindal CJ said, at p. 91:

> The principle that the insured stands as trustee for the insurer, after the latter has paid, is established by the case of *Randal v. Cockran*: whatever money therefore the plaintiff may recover in the present action, equity will undoubtedly compel him to pay over to the underwriters.

Park J. followed the decision in *Mason v. Sainsbury* [1782] 3 Doug. 64, holding that there would be no double recovery by the assured since he would hold the damages recovered as trustee for the insurer. Both *Mason v. Sainsbury* and *Yates v. White* were approved by this House in *Simpson & Co. v. Thomson* 3 App. Cas. 279.

Next, the question arose whether an insurer entitled by way subrogation could at law sue a third party wrongdoer in his own name or only in the name of the assured. It was held that he could sue in the name of the assured: *London Assurance v. Sainsbury* 3 Dougl. 245. Lord Mansfield said:

> If the insurer could sue in his own name, no release by the insured would bar, nor would a verdict by him be a bar. It is impossible that the insured should transfer, and yet retain his right of action. Trustee and *cestui que trust* cannot both have a right of action.

However, in my judgment the decisive case is *White v. Dobinson* [1844] 14 Sim. 273 and 116 LTOS 233. In that case, Hicks had insured the ship "*Diana*" with the plaintiff. *Diana* was in collision with "*Xenophon*" owned by Dobinson. The plaintiff paid the full sum due under the insurance to Hicks. Hicks then brought an action against Dobinson as owner of the *Xenophon* and was awarded £600 damages. Hicks had assigned to a bank whatever he recovered from the owner of the *Xenophon*. The plaintiff sought, and the Vice Chancellor granted, an interlocutory injunction restraining Hicks from receiving and Dobinson from paying the £600 damages without first recouping to the plaintiff the amount of the insurance he had paid, on the ground that by way of subrogation the plaintiff had a lien in equity on the fund. Lord Lyndhurst LC upheld the Vice Chancellor's decision, but discharged the injunction against Dobinson. First, the Lord Chancellor disregarded the rights of the bank as assignee from Hicks since the bank's rights were "subject to all the equities which would have affected the money recovered." Second, he held that "the underwriters have a claim upon the fund awarded, and are entitled in some shape or other to recover back the money they have paid."

Although this was only an interlocutory decision, it was argued for two days and decided by a distinguished Lord Chancellor. It is clear

that it recognised that the insurer enjoyed a proprietary right in the damages (not merely a personal right of recovery from Hicks) both because the injunction froze the damages *in specie* and because the assignment of the damages to the bank was disregarded as being subject to the plaintiff 's equities in the fund. This is therefore a clear decision before the fusion of law and equity that equity treated an insurer entitled to be subrogated as having a proprietary interest in damages recovered from a third party wrongdoer.

However, it should be noted that Lord Lyndhurst did not continue the injunction against the third party wrongdoer, Dobinson. The case therefore established only that there is a proprietary right in the damages once recovered by the assured.

In *In re Miller, Gibb & Co. Ltd.* [1957] I WLR 703 the insurer was held to have a proprietary interest in the damages recovered from the third party wrongdoer. In my judgement, that case was rightly decided.

With one possible exception we were not referred to any decided case pointing in the other direction. The Court of Appeal in the present case treated the decision in *Stearns v. Village Main Reef Gold Mining Co.* [1905] 10 Com. Cas. 89 as being to the contrary effect. ln that case, gold belonging to the defendants' had been insured by the plaintiffs. The Transvaal Government, shortly before the outbreak of the Boer War, commandeered the defendants' gold to the value of £21,880. In 1899, the defendants were paid £7,239 odd by the Transvaal Government, which payment the Court decided had to be treated as a reduction in the defendants loss. On 2 August 1900 the plaintiffs, in ignorance of the payment by the Transvaal Government, accepted liability for the full £ 21,880 and paid the sum into the joint names of the plaintiffs and the defendants to await the outcome of certain other litigation. On 19 November 1902 the £21,880 together with the amount earned on it was paid out to the defendants. When the plaintiffs subsequently learned of the payment by the Transvaal Government, they sued to recover the £7,239 plus interest. The trial Judge held that the plaintiffs were entitled to recover the £7,239 plus interest from 2 August 1900 (the date of its investment in the joint names) until 19 November 1902 (the date of its payment out to the defendants). The defendants appealed and the plaintiffs cross appealed claiming interest down to the date of trial on the ground that the defendants were trustees. Only Stirling LJ dealt in his judgment with the cross appeal. He rejected the claim for interest holding that the relationship was one of debtor and creditor not that of trustee and *cestui que trust*.

That case is difficult to understand. So far as trusteeship was concerned, there was no fund capable of being the subject matter of a trust since the moneys were recovered by the assured from the third party (the Transvaal Government) before the plaintiff insurers settled the insurance claim. It was a case of over payment by the insurers under a mistake, not subsequent recovery by the assured from a third party of a fund for which the assured was accountable to the insurer. The only possible form of equitable relief in that case would be to have imposed on the assured some form of constructive trusteeship not of specified funds but as a general equitable liability.

Although the principles underlying subrogation as stated in *Castellain v. Preston* [1883] 11 QBD 380 apply to sums recovered from a third party whether such recovery takes place before or after the insurers have paid under the policy, the proper legal analysis of the parties' rights does depend on the order of receipts. If the assured recovers from the third party (thereby reducing the insured loss) before the insurers have paid under the policy, there is an over payment of the insurance money: there is no fund of money which can be the subject matter of a trust or charge. If, on the other hand, the assured does not recover from the third party until after payment of the insurance moneys the moneys recovered from the third party constitute a defined fund which can be impressed with a lien or trust.

The decision of Stirling LJ in that case goes no further than the facts of that case demanded, namely to hold that an over-paid assured is not accountable as a constructive trustee for the amount of the over-payment, there being no defined trust fund. He was not considering a case where there was a defined fund arising from a subsequent recovery by the insured which the insured was still holding.

In my judgment therefore an insurer who has paid over the insurance moneys does have a proprietary interest in moneys subsequently recovered by an assured from a third party wrongdoer. Although many of the authorities refer to that right as arising under a trust, in my judgment the imposition of a trust is neither necessary nor desirable: to impose fiduciary liabilities on the assured is commercially undesirable and unnecessary to protect the insurers' interests. In my judgment, the correct analysis is as follows. The contract of insurance contains an implied term that the assured will pay to the insured out of the moneys received in reduction of the loss the amount to which the insured is entitled by way of subrogation. That contractual obligation is specifically enforceable in equity against the defined fund (that is, the damages) in just the same way as are other contracts to assign or charge specific property, e.g. equitable assignments and equitable charges. Since equity regards as done that which ought to be done under a contract, this specifically enforceable right gives rise to an immediate proprietary interest in the moneys recovered from the third party. In my judgment, this proprietary interest is adequately satisfied in the circumstances of subrogation under an insurance contract by granting the insurers a lien over the moneys recovered by the assured from the third party. This lien will be enforceable against the fund so long as it is traceable and has not been acquired by a *bona fide* purchaser for value without notice. In addition to the equitable lien, the insurer will have a personal right of action at law to recover the amount received by the assured as moneys had and received to the use of the insurer.

As to the question whether the insurers have a proprietary interest in the assured's cause of action against the third party (as contrasted with the damages actually recovered) I prefer to express no concluded view. I do not think that the proprietary interest in the damages necessarily postulates a pre-existing proprietary interest in the cause of action. The contrary view could be reached by an argument along the following lines. Any equitable proprietary right must be based on the contract between the insurers and the assured. The implied terms of such contract are established by the decided authorities. Some of those implied terms may be inconsistent with the insurers having any right of property in the cause of action as opposed to the damages recovered. Thus, the third party can compromise the claim with the assured alone, without requiring the concurrence of the insurers. Again, the third party will obtain a good discharge for a judgment only if he pays the assured as opposed to the insurers. If the insurers have a proprietary interest in the cause of action it could be argued that the assured alone could neither effect a valid compromise nor give a good discharge: the insurers also would have to be parties. Accordingly, it could be said that the implied terms of the contract between the insurers and the assured are such that equity would not be specifically enforcing the parties' bargain if it treated the insurers as having proprietary rights in the cause of action inconsistent with the rights of the assured and that accordingly the rights of the insurers are purely personal rights to require the assured either to pursue the cause of action against the third party or to permit the insurers to do so in his name. But there are plainly factors pointing the other way and since the question was not fully argued I prefer to express no view on the point.

For these reasons, in addition to those given by Lord Templeman and Lord Jauncey of Tullichettle, I would allow the appeal and dismiss the cross appeal.

Lord Slynn of Hadley

My Lords,

I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Templeman. I agree that, for the reasons he gives, the appeal should be allowed and the cross appeal dismissed.